No. 86-88

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

CITICORP INDUSTRIAL CREDIT, INC.,
Petitioner,
v.
WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

REPLY BRIEF

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REPLY BRIEF

The petition presents one fundamental question: whether, in enacting the "hot goods" provision of the Fair Labor Standards Act (29 U.S.C. § 15(a)(1)), Congress intended not only to provide a remedy against an employer's payment of substandard wages, but also to effect massive changes in otherwise applicable state and federal laws governing the relative priority of creditors' claims against insolvent debtors.

The Secretary cannot deny the clear conflict among the courts of appeals on the question presented, and his assertion (Resp. Br. 7) that the conflict is "neither sufficiently fixed nor of sufficient importance to warrant consideration by this Court" is wrong. The Secretary offers

no assurance that he will not use to considerable advantage the first appellate court endorsement of his novel reading of the FLSA; in fact, the Secretary's brief suggests that the Sixth Circuit victory will be used to press FLSA claims against secured creditors at every opportunity.[1] Moreover, none of the arguments raised in opposition to the petition warrants a departure from this Court's usual practice of reviewing acknowledged conflicts in the courts of appeals concerning significant issues that affect a broad range of interests.

1. Resolution of the conflict among the courts of appeals as to the scope of § 15(a)(1) of the FLSA is of immediate and substantial practical importance to the commercial finance industry. The consequences for commercial lenders of the existing uncertainty generated by the Sixth Circuit's holding in this case are described in the petition and at length in the *amicus* brief of the National Commercial Finance Association ("NCFA Br."). Pet. 10-11; NCFA Br. 4-9. The Secretary does not deny the likely impact of the Sixth Circuit's holding on the commercial finance industry; he ignores it.

Instead, the Secretary points to the absence of reported cases as evidence that the question presented is not sufficiently important to warrant review in this Court. Resp. Br. 17-18. As counsel for the Secretary explained in the courts below, however, the absence of reported cases is testament to the effectiveness of § 15(a)(1) as a club to coerce secured creditors to pay the wages of their debtors' employees (C.A. App. 66):

> "Your Honor, there's not much case law, as TRO's have been issued, usually, and after they are issued parties get together and pay everybody, and [the case] never goes any further than that."

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[1] *See generally* Brief of the National Commercial Finance Association as *Amicus Curiae* ("NCFA Br.") 5.

See NCFA Br. 6. In cross-examining one of Citicorp's officers in the district court, the Secretary's counsel went further, intimating that the question has arisen in "numerous cases . . . filed . . . in the last few years. . . . (C.A. App. 313).[2] See also Resp. Br. 17-18 n.11. Thus, far from supporting the Secretary's assertion that the question presented does not warrant review, the absence of reported cases suggests compelling reason for immediate review by this Court of the Secretary's improper use of § 15(a)(1) to force secured creditors to pay the wages of their insolvent debtors' employees.

Alternatively, the Secretary argues that the admitted conflict among the courts of appeals is not "sufficiently fixed" to warrant review in this Court. Resp. Br. 17-18. According to the Secretary, the Second Circuit someday might reconsider its 20-year old holding in *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730 (1966), because an irrelevant provision in the Bankruptcy Code now permits certain types of enforcement proceedings against a bankrupt.[3] The Secretary's argument is unpersuasive, at best. First, the holding in *Powell Knitting* rests on the court's analysis of the purpose of the FLSA and common sense, not any potential conflict with the provisions of the Bankruptcy Act, as it existed in 1966. Second, while there is always a theoretical possibility that a court may reconsider a prior decision, that bare possibility is hardly sufficient basis for tolerating a clear and significant conflict in the courts of appeals concerning the scope of a national statute. Third, the possibility that the Second Circuit—or perhaps the Sixth Circuit—may one day re-

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[2] C.A. App. 313 ("Are you aware that numerous cases have been filed throughout this country in the last few years involving 'hot goods' and secured creditors which have been resolved and have never been reported; you are not aware of that, are you?").

[3] The Bankruptcy Code provision is irrelevant because this case concerns the priority of creditors' claims, not whether an action may proceed. The provision on which the Secretary now relies played no role in the analysis of the Sixth Circuit or that of either of the district courts in this case.

consider their respective decisions does nothing to mitigate the immediate consequences to the commercial finance industry of the existing uncertainty. In fact, to the extent the Secretary's brief (Resp. Br. 17-18) reflects an intention to revisit the issue in the Second Circuit and the Fourth Circuit, there is even greater uncertainty for the commercial finance industry.

The Secretary's casual suggestion that "application of the [*Schultz* v. *Factors, Inc.* 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971)] test to the record here would probably not have changed the outcome" (Resp. Br. 19 n.12) is insupportable. The facts in this case and those in both *Powell Knitting* and *Factors* are indistinguishable. Contrary to the suggestions of the Secretary (*e.g.*, Resp. Br. 3, 4-5 n.2, 14, 18-19 n.12), there is no evidence of any wrongdoing by Citicorp, or anything that could be characterized as "collusion." As both district courts acknowledged, "the employees and the secured creditor [*i.e.*, Citicorp] are innocent parties. . . . (Pet. App. 25a-26a, 33a; see Pet. App. 10a). Citicorp did not make or control Ely's payroll decisions.[4] Until the Sixth Circuit's

[4] The Secretary suggests that "creditors . . . like [Citicorp] closely oversee the operations" of their debtors (Resp. Br. 12; *see id.* 2), and therefore control or should control the management of their debtors' businesses—particularly the payment of employee wages. That suggestion is incorrect, as a matter of fact, and moreover ignores commercial reality. There is a wide gulf between oversight and control, and there is no evidence of the latter in this case. As explained by the NCFA, a secured creditor's attempt to control its debtor's business would raise a "variety of serious business and legal problems" (NCFA Br. 9), including exposure to increased potential liability. Further, contrary to the Secretary's apparent assumption, "close" oversight by secured creditors will not avoid non-payment of employee wages. The creditor would become aware of its debtor's failure to pay employees only after the damage had been done; under the Sixth Circuit's holding, once the payroll is missed, the Secretary is entitled to an injunction preventing sale of collateral by a secured creditor. Finally, it is the propriety of using § 15(a)(1) to pressure secured creditors, whether to pay the wages of its debtor's employees or to police its debtor's payroll decisions, that is at issue.

decision in this case, every appellate court that had considered the issue had concluded that § 15(a)(1) imposed no obligation on a secured creditor to assure that its debtor's employees were paid before selling collateral.

2. As set out in the petition, the holding of the Sixth Circuit effectively establishes a federal lien or trust for employee-wage claims superior to earlier perfected security interests and other consensual, statutory, or judicial liens, contrary to state law. Pet. 14-16. The phrase "any person" is broad enough to include a secured creditor, but it is undisputed that "Congress never directly considered the question whether the hot goods provision applies to secured creditors" (Pet. App. 12a). Moreover, there is no evidence that, in enacting the FLSA, Congress intended wholesale displacement of state policy judgments concerning the priority of creditors' claims against insolvents. The sole purpose of the FLSA was to establish decent wages and hours for American workers. Thus, the critical dispute in this case is whether the general language of a federal statute addressing labor wage and hour standards is properly construed to preempt state law governing the priority of creditors' claims, without any evidence that Congress intended to do so. The Secretary responds that to the extent of any conflict "federal law would control" (Resp. Br. 14 n.8). Clearly-established principles of federalism require more respect for state legislation.

Absent persuasive evidence that Congress intended to displace state law governing the priorities of creditors of insolvent corporations, the general language of a federal statute should not be construed to have such an effect.[5] "[T]he principal means chosen by the Framers to ensure

[5] *See, e.g., Louisiana Public Service Commission* v. *FCC*, 106 S. Ct. 1890, 1899 (1986); *Philko Aviation, Inc.* v. *Shacket*, 462 U.S. 406, 409-411 & nn.2-4 (1983); *In the Matter of Gary Aircraft Corp.*, 681 F.2d 365, 368-372 (5th Cir. 1982), *cert. denied*, 462 U.S. 1131 (1983).

the role of the States in the federal system lies in the structure of the Federal Government itself." [6] When generally-worded provisions of a federal statute are construed to supersede state policy judgments—without any evidence of consideration by Congress—the safeguards for federalism inherent in the structure of the national government cannot "perform[] as intended" (*Garcia* v. *San Antonio*, 469 U.S. at 556).[7] "[T]he implications and limitations of our federal system constitute a major premise of all congressional legislation," and therefore Congress "will not be deemed to have significantly changed the federal-state balance . . . unless otherwise the purpose of the Act would be defeated." [8] The Secretary's effort in this case to satisfy the heavy burden of persuasion imposed by the "implications and limitations of our federal system" fails.[9]

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[6] *Garcia* v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 550 (1985); *see generally* H. Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 Colum. L. Rev. 543 (1954).

[7] Whatever doubt there may be as to whether those "safeguards" are sufficient, *see Garcia* v. *San Antonio*, 469 U.S. at 565-566 & n.9 (Powell, J., dissenting); *id.*, 469 U.S. at 584, 587 (O'Connor, J., dissenting), construing the general language of a federal statute to supersede state laws on matters of primarily local concern without evidence that Congress ever considered, much less intended such a result, renders those safeguards wholly ineffective.

[8] *Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2121 & nn.32-33 (1986) (plurality opinion); *see Kirschbaum Co.* v. *Walling*, 316 U.S. 517, 520-522 (1942).

[9] The potential conflict with other federal legislation created by the Sixth Circuit's construction of § 15(a)(1) is an additional reason for rejecting the court's conclusion. *See* Pet. 11-12. The Secretary flatly asserts (Resp. Br. 13 n.8) that there is no "possibility of conflict between the reach of Section 15(a)(1)" and other federal statutes or state statutes, apparently because "[t]he FLSA, unlike those statutes, does not create a lien." Nonetheless, he offers no explanation of how § 15(a)(1), as interpreted by the Sixth Circuit, could be applied in a case involving the Packers and Stockyards Act or the Perishable Agricultural Commodities Act, without frustrating Congress' manifest intent; nor does the Secretary explain how labeling the FLSA something other than a "lien" statute avoids the demonstrated conflict among the federal statutory schemes created by the Sixth Circuit's interpretation of the FLSA.

Contrary to the Secretary's argument (Resp. Br. 7-13), neither the language nor the purpose of the Act requires the result reached by the Sixth Circuit. Section 15(a)(1) provides a "strong incentive to employers to adhere to the Act's minimum wage and overtime provisions" (Resp. Br. 12), but Citicorp was not the offending employer and exercised no control over its debtor's payroll. Section 15(a)(1) also denies an employer "the unfair competitive advantage" of selling goods produced in violation of the Act. But Congress was concerned about the "unfair competitive advantage" of sellers of cheap goods because competition from such sellers would "exert downward pressure on wages" (*Tony & Susan Alamo Foundation* v. *Secretary of Labor*, 105 S. Ct. 1953, 1962 (1985)). Citicorp is not in the business of selling sweaters or hosiery, and therefore neither sought nor obtained any "competitive advantage" when it was forced to sell the collateral. Citicorp's only interest was in liquidating the collateral at the best price obtainable in the market in the hope of securing repayment of some part of its loans. A secured creditor's sale of collateral poses no danger of affecting wage rates. See Pet. 19-20.[10]

The focus of the FLSA was the wages and hours of employees of ongoing businesses, not the priority of creditors' claims against a failed business. Thus, whether § 15(a)(1) would have prevented Ely from shipping the inventory, as the Secretary asserts (Resp. Br. 9 n.6) is not conceded, but the far more difficult question presented in this case is whether § 15(a)(1) is properly invoked

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[10] Further, in focusing on the exclusion of "contraband" from the channels of interstate commerce and ignoring Congress' reason for excluding such goods (*e.g.*, Resp. Br. 4, 6, 7, 9), the Secretary confuses the mechanism for enforcement with Congress' purpose.

against a secured creditor. As explained in the petition (Pet. 16-19), § 15(a)(1) was broadly worded to bring within its reach all employers in the chain of production and distribution to avoid circumvention, not to provide a mechanism for coercing an innocent creditor to pay the wages of its debtor's employees.[11] Neither the omission of the limited provision authorizing a Labor Standards Board to grant exemptions from § 15(a)(1) nor the 1949 amendment to § 15(a)(1) provides any support for the Secretary's position in this case. Since only the government was authorized to enforce § 15(a)(1), the proposed exemption authority was unnecessary. Pet. 16-17 n.25. The Secretary's suggestion (Resp. Br. 11) that in omitting this narrow provision, *without comment*, Congress intended to punish innocent parties who acquired "hot goods" in the ordinary course of business is wildly implausible. Similarly, as explained in the petition (Pet. 20 n.33), the 1949 amendment worked no change in the law and was adopted without controversy; it simply confirmed Congress' obvious intent in enacting § 15(a)(1) in 1938.

In sum, there is no evidence that, in 1938 or at any time thereafter, Congress actually considered creating a "secret" trust or lien for employee-wage claims superior to a perfected security interest in inventory and, there is no basis for assuming that if it had considered the issue, Congress would have intended to preempt state law traditionally governing such matters. Accordingly, the general language of § 15(a)(1), should not be construed to have effected such a result—nearly 50 years after the enactment of the FLSA. The provisions of state and federal law that deal directly and explicitly with the

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[11] Cases such as *Southern Advance Bay & Paper Co.* v. *United States*, 133 F.2d 449 (5th Cir. 1943); *Wirtz* v. *Lone Star Steel Co.*, 405 F.2d 668, 670 (5th Cir. 1968); and *Walling* v. *Acosta*, 140 F.2d 892, 894 (1st Cir. 1944), on which the Secretary relies (Resp. Br. 9-10), therefore, provide no support for the contention that § 15(a)(1) should be extended to an innocent secured creditor.

relative priorities of creditors' claims deserve far more careful consideration than the Sixth Circuit's implicit repeal. Unlike the government, the Sixth Circuit clearly acknowledged the conflict. For the reasons stated in the petition and by the NCFA as *amicus curiae*, it is a conflict that will have significant consequences for the nation's commercial lending industry unless promptly resolved.

CONCLUSION

The petition for a writ of certiorari to the Sixth Circuit should be granted.

Respectfully submitted,

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